Fundamentals of
MULTINATIONAL FINANCE

Questions & Answers

Prepared By: Ahmed M. Samy El-Hamaky

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Chapter 3
The International Monetary System

Multiple Choice and True/False Questions

1) The price of one country's currency in units of another currency or commodity is the ________.
A) foreign interest rate
B) foreign currency exchange rate
C) par value
D) international rate

2) A country that regulates the rate at which its currency is exchanged for all other currencies is considered to h ave a ________ exchange rate system.
A) fixed or managed
B) floating or flexible
C) forward
D) spot

3) You check the Yahoo.com currency web page and find that the Japanese yen is trading at a rate of 113 yen per dollar. This rate of exchange is typically referred to as the ________.
A) forward rate
B) par rate
C) spot rate
D) 113 rate

4) The drop in value of a currency pegged to gold or another currency is known as ________.
A)revaluation
B) depreciation
C) deterioration
D) devaluation

5) A ________ currency is expected to devalue or depreciate relative to major currencies.
A) soft or weak
B) hard or strong
C) deteriorated
D) devalued

6) The increase in value of a currency pegged to gold or another currency is known as ________.
A) appreciation
B) revaluation
C) strengthened
D) hardened

7) A currency that has increased in foreign exchange value relative to a floating rate currency has ________.
A) revalued
B) violated international trade agreements
C) appreciated
D) deteriorated

8) A currency that has decreased in foreign exchange value relative to a floating rate currency has ________.

A) revalued
B) appreciated
C) devalued
D) depreciated

9) The ________, as of December 2007, is the common currency for 13 of the countries that are members of the European Union.
A) SDR (Special Drawing Rights)
B) ECU (European Currency Unit)
C) Euro
D) Yugo

10) A United States firm had chosen to deposit money in a British bank and have it denominated in U.S. dollars. This is an example of a (an) ________ deposit.
A) imPounded
B) Euroyen
C) Europound
D) Eurodollar

11) Under the gold standard of currency exchange that existed from 1879 to 1914, an ounce of gold cost $20.67 in U.S. dollars and £4.2474 in British pounds. Therefore, the exchange rate of pounds per dollar under this fixed exchange regime was
A) £4.8665/$.
B) £0.2055/$.
C) always changing because the price of gold was always changing.
D) unknown because there is not enough information to answer this question.

12) World War I caused the suspension of the gold standard for fixed international exchange rates because the war
A) cost too much money.
B) interrupted the free movement of gold.
C) lasted too long.
D) used gold as the main ingredient in armament plating.

13)A speculative technique whereby the speculator sells an asset that he/she doesn't own, such as a currency, to an other party for delivery at a future date is called ________.
A) selling ahead
B) selling behind
C) selling short
D) selling long

14) Which of the following investment strategies will allow me to make a profit if I anticipate that the value of the Euro, a currency that I do not own, is going to fall over the next 90 days and I am correct in my prediction?
A) Sell Euros short.
B) Buy Euros short.
C) Sell dollars short.
D) Buy Euros long.

15) The post WWII international monetary agreement that was developed in 1944 is known as the ________.
A) United Nations

B) League of Nations
C) Yalta Agreement
D) Bretton Woods Agreement

16) Another name for the International Bank for Reconstruction and Development is
A) the Recon Bank.
B) the European Monetary System.
C) the Marshall Plan.
D) the World Bank.

17) The International Monetary Fund (IMF)
A) in recent years has provided large loans to Russia, South Korea, and Brazil.
B) was created as a result of the Bretton Woods Agreement.
C) aids countries with balance of payment and exchange rate problems.
D) is all of the above.

18) Under the terms of Bretton Woods countries tried to maintain the value of their currencies to within 1% of a hybrid security made up of the U.S. dollar, British pound, and Japanese yen.
FALSE

19) Members of the International Monetary Fund may settle transactions among themselves by transferring Special Drawing Rights (SDRs).
TRUE

20) Today, the United States has been ejected from the International Monetary Fund for refusal to pay annual d ues.
FALSE

21) Which of the following led to the eventual demise of the fixed currency exchange rate regime worked out at Bretton Woods?
A) widely divergent national monetary and fiscal policies among member nations
B) differential rates of inflation across member nations.
C) several unexpected economic shocks to member nations
D) all of the above

22)The IMFs exchange rate regime classification identifies ________ as the most rigidly fixed, and ________ as the least fixed.
A) exchange arrangements with no separate legal tender; independent floating
B) crawling pegs; managed float
C) currency board arrangements; independent floating
D) pegged exchange rates within horizontal bands; exchange rates within crawling pegs

23) Which of the following correctly identifies exchange rate regimes from less fixed to more fixed?
A) independent floating, currency board arrangement, crawling pegs
B) independent floating, currency board arrangement, managed float
C) independent floating, crawling pegs, exchange arrangements with no separate legal tender
D) exchange arrangements with no separate legal tender, currency board arrangement, crawling pegs
24) As of January 2002, the Independent Floating regime of exchange rate classifications was used byover 75% o f the 186 countries identified by the IMF.
FALSE

25) A small economy country whose GDP is heavily dependent on trade with the United States could use a (an) ________ exchange rate regime to minimize the risk to their economy that could arise due to unfavorable chang es in the exchange rate.
A) pegged exchange rate with the United States
B) pegged exchange rate with the Euro
C) independent floating
D) managed float

26) The United States currently uses a ________ exchange rate regime.
A) crawling peg
B) pegged
C) floating
D) fixed

27)Based on the premise that, other things equal, countries would prefer a fixed exchange rate: Variable rates p rovide stability in international prices for the conduct of trade.
FALSE

28)Based on the premise that, other things equal, countries would prefer a fixed exchange rate, which of the foll owing statements is NOT true?
A) Fixed rates provide stability in international prices for the conduct of trade.
B) Fixed exchange rate regimes necessitate that central banks maintain large quantities of international reserves for use in the occasional defense of the fixed rate.
C) Fixed rates are inherently inflationary in that they require the country to follow loose monetary and fiscal poli cies.
D) Stable prices aid in the growth of international trade and lessen exchange rate risks for businesses.
Answer:

29) Which of the following is not an attribute of the "ideal" currency?
A) monetary independence
B) full financial integration
C) exchange rate stability
D) All are attributes of an ideal currency.

30)If exchange rates were fixed, investors and traders would be relatively certain about the current and near fut ure exchange value of each currency.
TRUE

31) The authors discuss the concept of the "Impossible Trinity" or the inability to achieve simultaneously the goal s of exchange rate stability, full financial integration, and monetary independence. If a country chooses to have a pure float exchange rate regime, which two of the three goals is a country most able to achieve?
A) monetary independence and exchange rate stability
B) exchange rate stability and full financial integration
C) full financial integration and monetary independence
D) A country cannot attain any of the exchange rate goals with a pure float exchange rate regime.

32)The attempt by many countries to stimulate their domestic economies and to gain access to global financial markets, is causing more and more countries to choose a ________ or ________ exchange rate regime.
A) floating; monetary union

B) monetary union; full capital controls
C) full capital controls; floating
D) pegged; fixed

33) Beginning in 1991 Argentina conducted its monetary policy through a currency board. In January 2002, Argentina abandoned the currency board and allowed its currency to float against other currencies. The country took this step because
A) the Argentine Peso had grown too strong against major trading powers thus the currency board policies were hurting the domestic economy.
B) the United States required the action as a prerequisite to finalizing a free trade zone with all of North, South, and Central America.
C) the Argentine government lost the ability to maintain the pegged relationship as in fact investors and traders perceived a lack of equality between the Argentine Peso and the U.S. dollar.
D) all of the above.

34) In January 2002, the Argentine Peso was officially valued at a rate of Peso1.40/USD. More recently the exchange rate is Peso 3.10/USD, thus, the Argentine Peso ________ against the U.S. dollar.
A) strengthened
B) weakened
C) remained neutral
D) all of the above

35) On September 9, 2000 Ecuador officially replaced its national currency, the Ecuadorian sucre, with the U.S. dollar. This practice is known as ________.
A) bi- currencyism
B) sucrerization
C) a Yankee bailout
D) dollarization

36) You have been hired as a consultant to the central bank for a country that has for many years suffered from repeated currency crises and depends heavily on the U.S. financial and product markets. Which of the following policies would have the greatest effectiveness for reducing currency volatility of the client country with the United States?
A) dollarization
B) an exchange rate pegged to the U.S. dollar
C) an exchange rate with a fixed price per ounce of gold
D) an internationally floating exchange rate

37) A bank holiday
A) occurs every day after 3:00 p.m.
B) is a term used when a country's central government freezes (temporarily) all deposits in commercial banks.
C) is observed in Europe every fourth Friday.
D) occurs the last three working days of the year to prepare financial statements for tax purposes.

38)Which of the following is NOT an argument against dollarization?
A) The dollarized country's central bank can no longer act as a lender of last resort.
B) The dollarized country can no longer profit from seignorage (the ability to profit from the creation of money within its economy).
C) The dollarized country losses sovereignty over its own monetary policy.
D) All of the above are arguments against dollarization from the viewpoint of the affected country.

39)The Euro currency is fixed against other currencies on the international currency exchange markets, but allo ws member country currencies to float against each other.
FALSE

40) Even though the Euro currency has been designed and printed, it is still not available for general use by the p ublic, except for tourists, in the European Union.
FALSE

41) Which of the following is NOT a required convergence criteria to become a full member of the European Ec onomic and Monetary Union (EMU)?
A) National birthrates must be at 2.0 or lower per person.
B) The fiscal deficit should be no more than 3% of GDP.
C) Nominal inflation should be no more than 1.5% above the average inflation rate for the three members with t he lowest inflation rates in the previous year.
D) Government debt should be no more than 60% of GDP.

42)Which of the following groups of countries have replaced their individual currencies with the Euro?
A) France, Germany, and the United Kingdom
B) Sweden, Denmark, and Greece
C) The United Kingdom, The Netherlands, and Austria
D) Germany, The Netherlands, and Italy

43) The tremendous international mobility of financial capital is forcing emerging market nations to adopt one o f two polarized choices, free float or currency board, for their foreign currency exchange regimes. Which of the f ollowing would NOT be a reason for an emerging nation to choose to have their currency freely float?
A) The country desires to lose political influence on the valuation of their currency.
B) The emerging nation desires an independent monetary policy.
C) The emerging nation is willing to tradeoff exchange rate stability to gain free movement of capital.
D) All of the above.

44) According to the authors, what is the single most important mandate of the European Central Bank?
A) Promote international trade for countries within the European Union.
B) Price, in euros, all products for sale in the European Union.
C) Promote price stability within the European Union.
D) Establish an EMU trade surplus with the United States.

45) Ignoring transaction costs and based solely on the change in currency exchange rates, a speculator who sold short a two years
contract for the euro (receiving dollars) in January 2006 would have realized a profit upon the exercise of the co ntract in January 2008.
FALSE

46) Which of the following is a way in which the euro affects markets?
A) Countries within the Euro zone enjoy cheaper transaction costs.
B) Currency risks and costs related to exchange rate uncertainty are reduced.
C) Consumers and business enjoy price transparency and increased price-based-competition.
D) All of the above.

47) A special Drawing Right is a unit of account established by

A) the Federal Reserve Bank.
B) the World Bank.
C) the International Monetary Fund.
D) the European Central Bank.

48) A currency is considered *hard* if
A) it is expected to be revalued or appreciate.
B) it is expected to be devalued or depreciate.
C) it is backed in part by a precious metal such as gold.
D) it is difficult to trade on the international currency exchange markets.

49) Under a fixed exchange rate regime, the government of the country is officially responsible for
A) intervention in the foreign exchange markets using gold and reserves.
B) setting the fixed/parity exchange rate.
C) maintaining the fixed/parity exchange rate.
D) all of the above.

50) ________ are domestic currencies of one country on deposit in a second country.
A) LIBORs
B) Eurocurrencies
C) Global Federal Funds
D) FOREX Funds

51) Which of the following is NOT an example of a Eurocurrency deposit?
A) British pounds deposited outside of the United Kingdom
B) Japanese yen deposited outside of Japan
C) U.S. dollars deposited outside of the United States
D) All of the above could be considered Eurocurrency deposits.

52) Which of the following would NOT be a valuable Eurocurrency market transaction?
A) Ford Motor Company holds temporary excess dollars in a London bank.
B) Dell Computer borrows dollars from a German bank to fund accounts receivable.
C) Volkswagen borrows Euros in France to finance working capital.
D) A Russian oil firm deposits dollars in Moscow Narodny Bank in London.

53) Generally, Eurocurrency loans are based on the London Interbank Offered Rate (LIBOR) and have a lower off ering rate because
A) Eurocurrency markets are a wholesale market.
B) transaction sizes are for very large amounts of money.
C) market participants have very good credit ratings.
D) all of the above.

54) Eurocurrency markets are subject to more stringent reserve requirements than those imposed on U.S. bank s by the Federal Reserve.
FALSE

55) For at least two years from early 2006 to early 2008, the euro maintained a strong and steady rise in value a gainst the U.S. dollar (USD). Which of the following were NOT a contributing factor in the assent of the euro and t he decline in the dollar?
A) severe U.S. balance of payments deficits

B) a general weakening of the dollar after the attacks of September 11, 2001
C) large U.S. balance of payment surpluses
D) All of the above were contributing factors.

56) In London an investor can buy a U.S. dollar for £0.5356. In New York the £/$ exchange rate is the same as fou nd in London. Given this information, what is the $/£ exchange rate in New York?
A) $1.8671/£
B) £0.5356/$
C) £1.8671/$
D) $0.5356/£

57) What was the annualized forward premium on the pound if the spot rate on January 20, 2005 was £0.5156$ and the 180 day forward rate was £0.5000/$?
A) 6.24%
B) 3.12%
C) 1.56%
D) 6.05%

Essay Questions

1) The mobility of international capital flows is causing emerging market nations to choose between a free-floating currency exchange regime and a currency board (or taken to the limit, dollarization). Describe how each of the regimes would work and identify at least two likely economic results for each regime.

Answer:

With free float the exchange rate is market determined and beyond the control of the country's central bank or government. The economic results are likely to be an independent monetary policy, free movement of capital, but less stability in the exchange rate. Such instability may be more than an emerging market country's small financial market can bear. A currency board on the other hand is an implied legislative commitment to fix the foreign exchange rate with a specific currency, generally the country's major trading partner. Dollarization is taking this policy to the extreme whereby the emerging market nation forgoes its currency for that of its major trading partner. An example of Dollarization is Panama using U.S. dollars as the official Panamanian currency. With such a regime, independent monetary policy is lost and political influence on monetary policy is eliminated. Further, the benefits accruing to countries as a result of the ability to print its own money, seignorage, is lost.

2) On January 4, 1999 the member nations of the EMU introduced a new unified currency, the euro, to replace the individual national currencies of many member nations. Identify and explain several of the arguments made both for and against the euro. Do you think the euro has proven to be a "good" idea? Why/Why not?

Answer:

Arguments for the euro include a stable currency for trading among the several member nations and eliminating the need to exchange currencies to make crossborder transactions among member nations thus increasing transactional efficiency and eliminating exchange rate risk. Other advantages include unification of the several European markets, transparency of prices in the member countries, and a larger market to compete against the United States.

Arguments against the euro include a loss of national heritage and pride in losing a longheld domestic currency. Governments lose exclusive control over seignorage, lack of national autonomy in fiscal and monetary policy, and inequality among member states in their production and financial market strengths and weaknesses. Member nations are forced to go along with the group even if a particular action does not maximize value to the individual countries.

As for whether the euro has been good or bad, this is an opinion piece for each student.

3) Most Western nations were on the gold standard for currency exchange rates from 1876 until 1914. Today we have several different exchange rate regimes in use, but most larger economy nations have freely floating exchange rates today and are not obligated to convert their currency into a predetermined amount of gold on demand. Occasionally several parties still call for the "good old days" and a return to the gold standard. Develop an argument as to why this is a good idea.

Answer:

The gold standard forces a nation to maintain sufficient reserves of gold to back its currency's value. This helps control inflation, as a country cannot print additional money without sufficient gold to back it up. The gold standard eases international transactions as there is little uncertainly about exchange rates for trade with foreign countries. A stable currency could also act as a deterrant to the large trade deficits developed by some countries such as the United States.

Chapter 4

The Balance of Payments

Multiple Choice and True/False Questions

1) The *balance of payments* as applied to a course in international finance may be defined as
A) the amount still owed by an exporting firm after making an initial down payment.
B) the amount still owed by governments to the International Monetary Fund.
C) the measurement of all international economic transactions between the residents of a country and foreign residents.
D) the amount of a country's merchandise trade deficit or surplus.

2) Balance of payment (BOP) data may be important for any of the following reasons:
A) BOP data helps to forecast a country's market potential, especially in the short run.
B) The BOP is an important indicator of a country's foreign exchange rate.
C) Changes in a country's BOP may signal a change in controls over payment of dividends and interest.
D) All of the above.

3) A country experiencing a serious BOP ______ is more likely to _____ exports than otherwise.
A) surplus; contract
B) deficit; contract
C) deficit; expand
D) none of the above

4) Which of the following would NOT be considered a typical BOP transaction?
A) Toyota U.S.A. is a U.S. distributor of automobiles manufactured in Japan by its parent company.
B) The U.S. subsidiary of European financial giant, Credit Suisse, pays dividends to its parent in Zurich.
C) A U.S. tourist purchases gifts at a museum in London.
D) All are example of BOP transactions.

5) The authors identify a tip for understanding BOP accounting.
They recommend that you "follow the cash flow."
TRUE

6) The BOP must be in balance but the current account need not be.
TRUE

7) Which of the following is NOT a part of the Current Account of BOP?
A) net export/import of goods
B) Balance of Trade
C) net portfolio investment
D) net export/import of services

8) Which of the following is NOT part of the Financial Account of the BOP?
A) net foreign direct investment.
B) net import/export of services
C) net portfolio investment
D) other Financial items
9) Expenditures by U.S. tourists in foreign countries for foreign goods or services are factored into BOP calculations.
TRUE

10) Which of the following is NOT an item to be considered in BOP calculations?
A) A foreign resident purchases a U.S. Treasury Bill.
B) A U.S.-based firm manages the development of an oil field in Kazakhstan.
C) A consumer buys a VCR made in Korea from a Wal-Mart store.
D) A U.S. citizen living in Minnesota travels to Winnipeg, Canada and buys a case of LaBatt's Canadian beer
.

11) The balance of payments is most like a(an) ________.
A) cash flow statement
B) balance sheet
C) income statement
D) proxy statement

12) The balance of payments
A) determines the eligibility of countries for IMF aid.
B) adds up the value of all assets and liabilities of a country on a specific date.
C) records all international transactions for a country over a period of time.
D) all of the above.

13) According to the authors, the following types of transactions dominate the balance of payments:
A) the exchange of guns for butter.
B) the exchange of stocks and bonds.
C) the exchange of goods and services.
D) the exchange of real and financial assets.

14) Which of the following is NOT an example of an exchange of financial assets?
A) the exchange of travel services
B) the exchange of stocks
C) the exchange of bonds
D) loans

15) Because current and financial/capital account balances use doubleentry book keeping it is unusual to f ind serious discrepancies in the debits and credits.
FALSE

16) Which of the following is NOT part of the balance of payments account?
A) the current account
B) the financial/capital account
C) the official reserves account
D) All of the above are BOP accounts.

17) The ________ includes all international economic transactions with income or payment flows occurrin g within the year.
A) capital account
B) current account
C) financial account
D) IMF account

18) If your company were to import and export textiles, the transactions would be recorded in the current account subcategory of ________.
A) services trade
B) income trade
C) goods trade
D) current transfers

19) The travel services provided to international travelers by United Airlines would be recorded in the current account subcategory of ________.
A) services trade
B) income trade
C) goods trade
D) current transfers

20) Anaconda Copper Inc. created a subsidiary in Chile last year to mine copper ore. The proportion of net income paid back to the parent company as a dividend would be recorded in the current account subcategory of ________.
A) services trade
B) income trade
C) goods trade
D) current transfers

21) The subcategory that typically dominates the current account is ________.
A) goods (merchandise) trade
B) services trade
C) income trade
D) transfer accounts

22) Over the last several years, the United States has run a ________ in the goods trade balance and a ________ in the services trade balance.
A) surplus; deficit
B) surplus; surplus
C) deficit; deficit
D) deficit; surplus

23) In general, the United States goods trade balance has grown increasingly positive over the last 3 years.
FALSE

24) In 2001 the United States posted a current account deficit of $393 billion. The bulk of the negative value came from
A) a net transfer deficit.
B) an income balance deficit.
C) a goods trade deficit.
D) an income trade deficit.

25) In general, as a country's income increases, so does the demand for imports.
TRUE

26)In general, a country's exports decrease as foreign income decreases.
TRUE

27) Over the last two decades the surplus on U.S. services trade has typically been ________ the deficit on U.S. goo ds trade.
A) greater than
B) equal to
C) less than
D) The relationship is constantly shifting from greater than to less than.

28) The ________ of the balance of payments measures all international economic transactions of financial assets.
A) current account
B) merchandise trade account
C) services account
D) capital/financial account

29) The financial account consists COMPLETELY of which three components?
A) stock investment, bond investment, and mutual fund investment
B) direct investment, stock investment, and bond investment
C) direct investment, portfolio investment, and other asset investment
D) mutual fund investment, portfolio investment, and stock investment

30) When categorizing investments for the financial account component of the balance of payments the ________ i s an investment where the investor has no control whereas the ________ is an investment where the investor has c ontrol over the asset.
A)direct investment; portfolio investment
B) direct investment; indirect investment
C) portfolio investment; indirect investment
D) portfolio investment; direct investment

31) Which of the following would NOT be considered a direct investment either into or from the United States?
A) the purchase of U.S. Treasury (debt) securities
B) Ford Motor Company building an assembly plant in Mexico
C) Honda of Japan building a manufacturing plant in Alabama
D) intel purchasing a chip manufacturing plant in Thailand

32) International debt security purchases and sales are defined as portfolio investments for financial account purpos es because by definition debt securities do not provide the buyer with ownership or control.
TRUE

33) In general there is consensus that ________ should be free but there is no such consensus that ________ should be free.
A) international investment; international goods trade
B) international investment; international trade
C) international trade; international goods trade
D) international trade; international investment
34) The two major concerns about foreign direct investment are
A) national defense and taxes.
B) who controls the assets and who receives the profits.
C) who receives the profits and taxes.
D) who pays the taxes and who receives the taxes.

35)Portfolio investment is capital invested in activities that are ________ rather than made for ________.

A) short term; the long term
B) long term; profit
C) profit motivated; control
D) control motivated; profit

36)Most U.S. debt purchased by foreigners is denominated in ________ and most foreign debt issued by countries such as Russia, Mexico, and Brazil is issued in ________.
A) U.S. dollars; the purchasing investor's domestic currency
B) the purchasing investor's domestic currency; the issuing country's domestic currency
C) U.S. dollars; the issuing country's domestic currency
D) U.S. dollars; U.S. dollars

37)Significant amounts of United States Treasury issues are purchased by foreign investors, therefore the U.S. must earneign currency to repay this debt.
FALSE

38) The role of official reserves is ________ under a ________ exchange rate regime.
A) enhanced; floating
B) diminished; fixed
C) enhanced; fixed
D) None of the above apply.

39)If most major economies are operating under a regime of fixed exchange rates, then a ________ in a country's balance of payments suggests that the country should ________ its currency.
A) surplus; revalue
B) surplus; devalue
C) deficit; revalue
D) all of the above

40) Under an international regime of fixed exchange rates, countries with a BOP ________ should consider ________ their currency while countries with a BOP ________ should consider ________ their currency.
A) deficit; revaluing; surplus; revaluing
B) deficit; devaluing; surplus; devaluing
C) surplus; devaluing; deficit; revaluing
D) surplus; revaluing; deficit; devaluing

41) The era between 1880 and 1914, when the gold standard was in use, was characterized by increasing capital mobility.
TRUE

42) The time from 1971 to today has predominately used a regime of variable exchange rates. It has also seen a decrease in capital mobility.
FALSE

43) Which of the following is the best definition of money laundering?
A) legal transfer of funds through the usual international payments mechanisms
B) the transfer of cash into collectibles that are then transferred across borders
C) the crossborder purchase of assets that are then managed in a way that hide the movement of money and its ownership
D) false invoicing of international trade transactions

44) The ________ is the difference between merchandise imports and exports and a measure of a country's internat ional trade in goods and services.
A) balance of payments
B) current account
C) capital account
D) balance of trade

45) The United States experienced a balance of trade ________ during the 1980s and a balance of trade ________ d uring the 1990s.
A) surplus; surplus
B) surplus; deficit
C) deficit; deficit
D) deficit; surplus

46) The largest single component of the United States current account is ________.
A) current transfers
B) income payments and receipts
C) goods (merchandise) imports and exports
D) services imports and exports

47) An excess of merchandise exports over merchandise imports results in a balance of trade deficit.
FALSE

48) Portfolio investments are transactions that involve longterm financial assets and affect the transfer of control.
FALSE

49) Which of the following does NOT represent a possible mechanism by which capital can be moved from country t o country?
A) transfers via the usual international payments mechanism such as regular bank transfers
B) transfers via a physical bearer such as smuggling
C) the transfer of cash into collectibles
D) All of the above are mechanisms for moving capital from country to country.

50) Which of the following statements about the balance of payments is not true?
A) The BOP is the summary statement of all international transactions between one country and all other countries.
B) The BOP is a flow statement, summarizing all international transactions that occur across the geographic borders over a period of time, typically a year.
C) Although the BOP must always balance in theory, in practice there are substantial imbalances as a result of statist ical errors and misreporting of current account and financial account flows.
D) All of the above are true.

51) Which of the following is not a component of the financial accounts?
A) direct investment abroad
B) direct investment domestic
C) goods imports
D) portfolio investment

52) The BOP should always balance.
TRUE

53) ________ is an entry in the balance of payments measuring the difference between the monetary value of merc handise exports and merchandise imports.
A) Balance of payments
B) Balance of trade
C) Import-export spread
D) None of the above

54) The beauty of the Jcurve adjustment path for trade balance adjustments is that the process is very quick, typicall y taking only a month or so to complete.
FALSE

55) The Jcurve adjustment path for trade balance adjustments assumes that export products are predominantly pric ed in the ________ currency and that import products are predominantly priced in the ________ currency.
A) domestic; domestic
B) domestic; foreign
C) foreign; foreign
D) foreign; domestic

56) The Jcurve adjustment path for trade balance adjustments assumes that ________ products are predominantly priced in the domestic currency and that ________ products are predominantly priced in the foreign currency
A) import; import
B) import; export
C) export; export
D) export; import

57) Assume that a country is experiencing a balance of trade deficit and then suffers a rapid depreciation of it's curr ency. Jcurve theory suggests that the trade balance will adjust in three distinct periods in the following order:
A) quantity adjustment period; passthrough period; currency contract period
B) passthrough period; currency contract period; quantity adjustment period
C) currency contract period; passthrough period; quantity adjustment period
D) passthrough period; quantity adjustment period; currency contract period

58) The immediate impact on the balance of trade (BOT) for a country in deficit when there is an immediate devalua tion of it's currency is likely to be an even larger BOT deficit than prior to devaluation.
TRUE

59) It is possible that the Jcurve path for BOT adjustments may be be elongated or even inapplicable if exports are N OT predominately priced in the domestic currency and/or imports are NOT predominately priced in the foreign curr ency.
TRUE

60) The United States, as of May 2007, had the largest official foreign exchange reserves of any nation.
Answer:
FALSE

61) China, as of May 2007, had the largest official foreign exchange reserves of any nation.
TRUE

Essay Questions

1) What is a country's balance of (merchandise) trade and why is it so widely reported in the financial and popular press?

Answer:

The balance of trade (BOT) is the largest and most important subset of a country's current account. It measures the difference in a country's imports and exports over a specified time period. It is often reported because it is intuitively easy to understand (i.e., we either sell more or buy more from foreign countries) and it is a reasonable representation of the total current account balance. (For example, for the U.S. the BOT was $779B in 2005 while the current account balance was $792B.

2) What is the Official Reserves Account (ORA) and why is it more important for countries under a fixed exchange rate regime than for ones under a floating exchange rate regime?

Answer:

The ORA is the total reserves held by official monetary authorities within the country. Under a fixed exchange regime a country's currency is convertible into a fixed amount of another country's currency. To keep the relationship between currencies at equilibrium, it may become necessary for the government to buy or sell official reserves until the equilibrium is restored. Under a variable rate regime this is not necessary as exchange rates are allowed to change and official reserves no longer serve the same purpose as under the fixed rate regime.

نسألكم الدعاء